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C O N F I D E N T I A L SECTION 01 OF 05 SANTO DOMINGO 003313

SIPDIS

SENSITIVE

STATE FOR WHA, WHA/CAR, WHA/EPSC, EB/OMA;
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USDOC FOR 3134/ITA/USFCS/RD/WH; DHS FOR CIS-CARLOS ITURREGUI

E.O. 12958: DECL: 06/04/2014
TAGS: PGOV EFIN DR
SUBJECT: DOMINICAN TRANSITION #1: TAKING REPONSIBILITY FOR
THE MESS

Classified By: DCM Lisa Kubiske. Reason: 1.4 (a) and (d).

¶1. (SBU) Following is number 1 in our series on the Dominican presidential transition:

Taking the Responsibility for the Mess
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(SBU) Both sides of this transition are apprehensive of taking blame for the pain necessarily associated with the IMF requirement to deliver a tax reform proposal to Congress by July. President Mejia has told the press he will deliver to legislators any draft text that has been fully discussed with everyone interested. Leonel Fernandez,s transition team told the Ambassador that they fully realize the urgency of the task and they expect Mejia to take the responsibility. Complicating all this is the revelation that the 2004 budget was driven 50 percent over planned expenditures by off-budget financing of construction and development projects. Fixing things with the IMF will be a huge job.

Meeting of the Transition Teams
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(U) Dominican media of May 31 carried photos from a press appearance of the two teams appointed to coordinate the transition between the May 16 presidential election and the August 16 inauguration. Leading for the Mejia government was Mejia,s running mate Rafael "Fello" Subervi, with Finance Minister Rafael Calderon, Intellectual Property Director Orlando Jorge Mera and former Agriculture Minister, campaign manager Eligio Jaquez. For Fernandez were PLD political strategist (former presidential candidate) Danilo Medina and PLD technical coordinator Temistocles Montas, with former Finance Minister Daniel Toribio, PRSC notable Carlos Morales Troncoso (sugar baron, former Vice President and former ambassador to Washington) and representatives from three minor parties supporting Fernandez: Pascual Prota (Fuerza National Progresista), Jose Francisco Pea Guaba (Bloque Institucional Social-democrata), former Lome Convention coordinator Max Puig (Alianza por la Democracia) and Jose Gonzalez Espinosa (Partido de los Trabajadores Dominicanos).

(U) Every individual in the photo is a politician deeply invested in his respective camp. All the PRD representatives are senior office holders; all the PLD representatives are either members of the PLD Political Committee or heads of allied parties.

IMF, Tax Reform and Finances
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(SBU) Among the most important issues on the table between the two transition teams is a highly charged technical issue: the requirement in the IMF program that the government deliver to Congress by the end of July a draft proposal for tax reform. Both sides are leaning as far back from this issue as possible, well aware that to be credible, any reform will mean raising tax collections, cutting spending or ending subsidies or some combination of the three. Short of the generally shunned solution of abandoning efforts to revise the badly faltering IMF program, there is no way to avoid the pain of decision.

(SBU) And the financial situation is about to get worse. Temporary taxes on 5 percent exports and special exchange levies of 10 percent on imports are set to expire this month, although such temporary measures in the past have sometimes continued indefinitely. The government continues to roll up debts for unpaid electricity subsidies and without a revised standby approved by the IMF board it has no further access to international lending to keep the electricity sector furnished with fuel. We expect that by mid-June the sector will be again into the sporadic widespread blackouts that characterized the end of 2003.

(U) Workers are beginning to press for early salary adjustments. The minimum wage is down 25 percent in real terms since last August and labor leaders are advocating a 60 percent across-the-board wage hike. Public sector physicians are insisting on a 100 percent wage hike. Air traffic controllers got nothing but a lock-out just before Easter. Government workers received a grossly inadequate 9 percent increase in December, 2003, a year of 40 percent inflation, and nothing since.

PLD and the Embassy
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(SBU) The Ambassador hosted the full PLD transition team on June 1 for a review of the issues of greatest importance to the United States. Opening the meeting, team members complained that PRD counterparts had provided nothing on the tax reform issue, despite the stipulation by the IMF that the package was to be prepared between January and March. The incoming administration was well aware of the need to preserve the IMF standby, they said, and without early cooperation by incumbents, it might be impossible to deliver a package to the PRD-dominated Congress before the end of ¶2004.

(U) The Ambassador told them that Dominicans were justifiably proud about the conduct of the 2004 elections, and that the political parties should strive to make this presidential transition process the best in Dominican history. That would require close consultation and cooperation between the administrations, a process that the Embassy stands ready to assist.

(SBU) Over the course of the luncheon the Ambassador outlined ongoing programs and bilateral concerns:

- - The world has changed since Fernandez,s 1996-2000 administration. The United States places the highest priority on measures against terrorism and corruption, regional security and law enforcement cooperation.

- - The bilateral agenda for long-term development needs to focus on education at all levels, institution building (especially in the judiciary), the investment climate, and public health concerns.

- Items requiring urgent attention in advance of the August 16 inauguration are the IMF and tax reform, airport and port security, an approach to energy sector problems, the status of Dominican consulates in the United States, trafficking issues and trade, especially the Free Trade Agreement (FTA).

(C) The Ambassador advised the team of the 90-day letter on Santo Domingo,s &Las Americas8 Airport from Homeland Security Secretary Ridge (delivered April 28) and informed them of the U.S. requirement to close unregistered Dominican consulates in the United States.

(C) The PLD transition team was attentive and appeared to be in general agreement with the Ambassador on these priorities. One notable and somewhat embarrassing exception came from Carlos Morales Troncoso, who sought to justify the current effort of Dominican sugar interests to re-open the text of the free trade agreement (in order to block any imports, of high fructose corn syrup, even on graduated 15-year terms). The Ambassador and senior staff told Morales that the FTA was a carefully balanced package and not open to revision. None of the other PLD team members made a comment.

(U) Medina and Montas as team leaders agreed to remain in close contact with senior Embassy officials as they elaborate the PLD set of working groups and sub-commissions over the next two weeks.

PRD and the Ugly Reality awaiting the IMF
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(SBU) That same afternoon the DCM and EcoPol counselor called on Mejia,s Technical Secretary Carlos Despradel, the official with primary responsibility for the IMF program and international financial matters. Despradel lost no time in laying out a financial situation far worse than he had earlier anticipated.

(C) According to his estimates and charts prepared for the IMF representatives arriving the next day (June 2), the Dominican government had come close to targets in its management of the central government budget. The government expenditures programmed for January-March had been 24.6m pesos, with revenues programmed to provide a significant surplus to contribute toward the non-fiscal deficit. In fact, revenue had been 4.5m higher than expected and expenditure 3.6m more than expected. These were the trends that Despradel had been reporting with a sense of

satisfaction to President Mejia. Mejia, he said, had insisted and was continuing to insist that the government respect the IMF standby program.

(C) Completely overwhelming these achievements was the accumulation of untracked expenditures for sectoral projects financed by bilateral or commercial lending or by new liabilities to the government-owned Banco de Reservas. Despradel hired specialists last year, principally from the Central Bank, in order to collect and centralize information on these activities, and the news was dismal. They had uncovered extensive activity in 2003 and 2004 never advised to Despradel, his staff or the IMF ) totaling approximately 1.5 pct of GDP. With these expenses rolled in, the January-March programmed expenditures of 24.6 billion pesos reached 37.75m, an over-expenditure of 13.1b (53.4 percent). In formal terms these undeclared expenditures and debts constituted misinformation and a failure to cooperate with the IMF; Despradel was downcast about this but expressed the hope that Fund officials would accept his good faith efforts to document the situation.

(C) Despradel commented that foreign export credit agencies and foreign commercial banks involved in development projects were able to exert a great deal of pressure through the benefiting Dominican agencies, Despradel commented, and there had been no formal mechanism by which he could control this activity. He had refused in most cases to authorize acceptance of these loans, most of which were at near-commercial rates; officials had turned to Finance Minister Rafael Calderon, who had signed them with little hesitation. The off-budget bilateral loans amounted to 4b pesos.

(C) In similar fashion but subject to even less control, the government-owned Banco de Reservas had guaranteed letters of credit requested by various government officials (primarily, Despradel implied, for imports for infrastructure projects). These letters were drawn up without clearance from central authorities; as payment came due, the guarantees were executed and became government liabilities to the Banco de Reservas. These off-budget liabilities totaled 3b pesos.

(C) Almost all of the remaining unprogrammed expenditure was financed by off-budget emergency loans from the Inter-American Development Bank and the World Bank (largely for fuel for the electricity sector) amounting to 2.5b pesos. Here there was no problem of misinformation; the IMF was aware of these loans and did not object to them.

(SBU) Despradel said that President Mejia was not aware of the extent of these uncontrolled off-budget expenditures. On May 20 Mejia instructed government ministries to suspend provisionally all expenditures for projects with foreign financing and he withdrew from Congressional consideration all previously submitted contracts for foreign-financed projects. Despradel traveled to Washington to inform Fund officials and was there at about the same time that the PLD team was visiting. Despite speculation in the Dominican press, the Fund did not conduct any joint meeting with outgoing and incoming Dominican administrations.

Consult and Cooperate or Face the Consequences
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(SBU) A lack of trust between the two transition teams is unsurprising. Four years of bitter rivalry have been stirred to a high heat by six months of campaigning. Many allege that the outgoing Fernandez administration deliberately delayed necessary fuel price hikes in 2000, leaving the dirty work to Mejia. (Fernandez,s team has a different story and set of justifications.)

(SBU) Mejia,s administration commissioned studies of tax reform from economic advisors Fundacion Economia y Desarrollo (Andy Dauhajre, Jr.) but the results, if any, had not been given to Despradel, who would have consulted the Fund with them. Mejia,s public comment is that he stands ready to submit to Congress any proposal that has been widely discussed and agreed. (The private sector, represented most vigorously by the entrepreneurs, association CONEP, has a firm grip on the political parties in any matters concerning commercial interests and taxation.) At the same time, the incoming Fernandez team does not want to share the blame for the almost inevitable pain of an increase in the value-added tax, the broadening of its application, or the cutting of subsidies. As the Dominicans say, "No one wants to inherit someone else,s dead bodies."

(SBU) A decision must be made, however, and if the rival teams refuse to cooperate with the IMF and with one another on financial stabilization, they will share the blame of perpetuating misery - - and of postponing the chances of recovery until some far future, perhaps even beyond the Fernandez administration. The Ambassador and Embassy are stepping into the gap between the mutally distrustful

political parties, emphasizing the need to set the national
interest above partisan advantage.
¶2. (U) Drafted by Michael Meigs .

¶3. (U) This report and other reporting series are available
on our SIPNET site at
http://www.state.sgov.gov/p/wha/santodomingo/ along with
extensive other material.
HERTELL